

A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from the NOVA – School of Business and Economics.

**A Shift to Lower Priced Plans in
Asia-Pacific**

André Veloso Feijó Fialho Moura
Number:33911

A Project carried out on the Master in (Economics/Finance/Management) Program, under the supervision of:

Professor: Francisco Martins

3rd January 2020

Abstract

In this report, it was explored the impact of a price decrease in Asia-Pacific, a strategy that Netflix started to test in some selected countries, in 2019. Through the analysis conducted, we notice that Asia-Pacific is a region where there is a big rising trend on smartphone usage, and the internet connectivity is penetrating very fast in the last years, which would facilitate the proliferation of the only-mobile plan, to attract the very high price sensitive consumers in the region.

Keywords

Netflix, Asia-Pacific, Pricing

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

Individual Report André Moura, n33911**A Shift to Lower Priced Plans in Asia-Pacific**

Netflix is the current SVoD leader in the world, with almost 160 million paid subscribers around the world, in which 60 million come from the United States and 98 million from international markets. In the first three quarters, Netflix only added around 2 million paid subscribers in the domestic segment, while it added 17 million in the International Streaming. With operations in 190 countries, Netflix relies its future expansion in the International Streaming Segment, since there are some regions with low penetrations, such as Asia-Pacific (7%), when compared with the 50% penetration in USA, or the 40% recorded in Canada. In order to reach a higher international penetration, Netflix must adapt its strategy to the socio-economic characteristics of each region. The pricing constitutes a very important issue because the company operates in countries with very different levels of disposable income. For instance, if we compare the median disposable income per household in India with the one in the US, we notice that there is a huge difference, since the Americans have 81 thousand dollars of disposable income per household, while the Indians only have 5 thousand dollars of disposable income (Passport).

A closer look to India

Back in the end of 2018, during a visit to India, Mr. Reed Hastings said: "Given the consumer base, the next 100 million [subscribers] for us is coming from India." In fact, India has a great potential, with a total population of 1.4 billion people, which accounts for almost 19% of the World population, being a very promising streaming market, given the rising penetration of internet connection. In 2018, Broadband penetration was 6% (18 million households) which is expected to grow until 7.5% in 2019 (Passport). Regarding mobile internet, in 2018, it reached 38% of the population (532 million subscriptions), an increase from 5.5% in 2014. In 2019, it is expected to reach 48% of the population (641 million users) (Passport). That said, we can

verify that there is a rising trend in internet connectivity, which helps the proliferation of internet-based services. This huge increase in internet usage is explained by the launch of Reliance Jio, a company that offers 4G services at very low prices in the country. Furthermore, the number of smartphone users is expected to reach 1.1 billion users by 2024, from 337 million users at the end of 2018, and 87% of video online watching is through a smartphone (Unravelling the digital video consumer, KPMG, 2019).

Nowadays, there are 39 SVoD players in the market, while, back in 2012, there were only 9. The main competition is coming from Hotstar and Amazon Prime Video.

Hotstar, a company owned by Star India, a subsidiary of Walt Disney Company, is the market leader in India, controlling 75% of the SVoD panorama in India with 300 million users (Manish Singh, 2019). It has 2 plans: the VIP plan which costs 365 Rs (5.12\$) per year, but it does not include the international content such as HBO original programming, and the all-inclusive plan which costs 199 Rs (2.8\$) per month or 999 Rs (14\$) per year.

Amazon Prime Video costs 129Rs (1.8\$) per month or 999Rs (14\$) per year and can be accessed through several platforms such as smartphones, tablets and game consoles. It offers a mix of International and local content in order to attract subscribers. Nowadays, it counts with 13 million paid subscribers in the country. (Rukmini Rao, 2019)

Given the high potential of this market, Netflix created an only-mobile plan at a cost of 199 Rs per month (the previous cheapest plan, which allows a person to stream in standard definition in one screen, costs 499Rs per month, which is 7\$), in July, in order to become more competitive and to increase the number of paid subscribers, which were 1.4 million, at the end of 2018 (Wendy Lee, 2019). Moreover, the company will invest 30 billion Rs, or 420.5 million dollars, in the following two years to create local original content, said Mr Reed Hasting in a conference at New Delhi. (Ari Altstedter, Ragini Saxena and Sam Nagarajan, 2019)

Asian Outlook

After India, Netflix has already started to test its pricing strategy in other Asian countries. For instance, it was introduced in South Korea a new pricing tier which costs ₩6500 per month (5.70\$), for an only-mobile plan, which is ₩3000 cheaper than the previous cheapest plan (Ruchi Gupta,2019). This is a response to the dominance of Pay TV services in the country. In 2018, South Korea had a 81% smartphone penetration, and it is expected to reach 90% in 2021, which will facilitate the proliferation of the new plan in a country where 95% of population have access to the internet (Passport,2019).

In Malaysia, in order to attract new subscribers (especially the young ones), Netflix implemented an only-mobile plan which costs 17 RM (4\$) (White, 2019) per month, which is almost 4\$ cheaper than the previous cheapest plan. In 2018, Malaysia recorded 54% of smartphone penetration, which is expected to reach 90% by 2023, demonstrating the rising trend on smartphone usage. (Passport)

All in all, Asia is a market in which this type of plan can result in an outstanding paid subscribers' growth due to the rise of smartphone usage, combined with the rising internet penetration and due to the high price sensitivity of the population. In fact, in 2018, 69.5% of total households already had at least 1 smartphone, and it is expected to reach 90% by 2020 (Passport). The internet penetration has seen an outstanding growth in recent years, with 82% penetration in 2018, from 30% in 2014, and it is expected to surpass the 91% in 2019 (Passport), which demonstrates the high potential of an only-mobile plan. The decrease in Pay Tv penetration from 2018 to 2023 (GlobalData,2019) shows that the cord-cutting phenomenon is rising, which facilitates the SVoD services proliferation.

Worldwide view

This new price plan is not suitable in more developed regions (like North America or Europe), since the disposable income in such areas is way higher, and the local content library is more robust than in Asia or Africa. Furthermore, existing subscribers could switch to the new plan, which would leave Netflix in a very difficult situation, since the revenues would decline and the company would have to reduce its content investment, which would reduce the power to attract and retain subscribers.

Regarding Latin America, although it is still behind in terms of internet penetration (71% internet penetration in 2018 against 142% in US) (Passport), there is a considerable amount of local content, since Spain and Latin America share great similarities not just in culture, but also in language, which justify the current pricing of Netflix in the region.

In Middle East & North Africa, although the smartphone penetration is expected to increase, the Pay TV is still in a rising trend (in 2018, the Pay TV penetration was 79%, which is expected to reach 80% in 2020) (Passport). Thus, the cord-cutting has not started yet. In Sub-Saharan Africa, the population has a low disposable income and the internet penetration is still very low (30% in 2018) (Passport), which does not contribute positively to a mobile-only plan. Furthermore, in both regions, Netflix has the market leadership, therefore, it is not expected that the company launches the new plan, since it would not enhance the revenues, as it could be seen as an incentive for subscribers to switch their plan.

Scenario Analysis

For these reasons, in this scenario we test the impact of a possible lower priced plan launch in Asia-Pacific. It will be considered that, from 2020 onwards, Netflix will implement this new pricing, which will impact the ARPU and Netflix's penetration rate (through market share), since in the three examples of pricing tests mentioned above, the price of the new plan is, on average, 50% of the previous cheapest one.

In Asia-Pacific, excluding China and North Korea (where Netflix does not operate), this plan will not be implemented in Australia and New Zealand, since these countries share great similarities with USA and the American content is suitable to the local population, and in Japan, since Netflix has already a robust local content library (Iqbal, 2019). That said, the only-mobile plan will have a target of 65% of Asia-Pacific population (Passport). Since most of competitors implement a pricing more similar to the new only-mobile plan than to the standard streaming plan and based on 2018 Asia-Pacific market analysis, 85% of Netflix's subscribers are expected to choose the new lower priced plan, while 15% will opt for a standard plan.

Although the introduction of the lower priced plan will decrease the ARPU by 28% to 6.8\$ in 2020 (in Base Scenario it is 9.39\$), it will increase the number of total paid subscribers in 2029 (98 million paid subscribers), reaching a penetration rate of 41%, which is higher than the base scenario (28%), due to bigger penetration in the following 4 years. Although it is projected that, until 2023, the base scenario's revenues in Asia-Pacific will be higher than the lower priced plan revenues (due to the ARPU decrease and the still low penetration rate in this period), in the long-run (2029), Asia-Pacific Revenues will reach the 8.83 billion dollars (8.3 billion dollars in the Base Scenario). Netflix will have 266 million international paid subscribers and a total of 351 million paid subscribers, in 2029 (319 million paid subscribers in the Base Scenario) and the total revenues will be 48 billion dollars, which are higher than the previous 47.4 billion dollars, in the Base Scenario, which demonstrate that this project can generate added value.

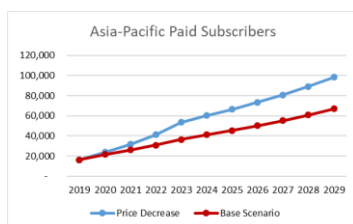


Exhibit 1: Asia-Pacific Paid Subscribers

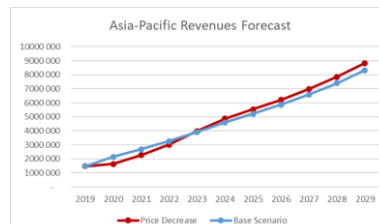


Exhibit 2: Asia-Pacific Revenues Forecast

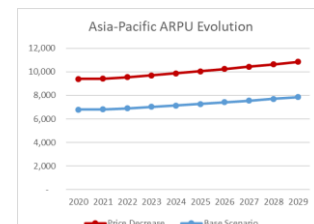


Exhibit 3: Asia-Pacific ARPU Evolution